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132628—37——1

In the Supreme Court of the United States

OCTOBER TERM, 1936

No. 750

D. W. MCEACHERN, ADMINISTRATOR OF THE ESTATE OF S. C. MCEACHERN, DECEASED, PETITIONER

v.

J. T. ROSE, FORMER COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF GEORGIA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

There was no formal opinion by the District Court. The opinion of the Circuit Court of Appeals (R. 76–81) is reported at 86 F. (2d) 231.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on November 9, 1936 (R. 81). By order of the Honorable Benjamin N. Cardozo, As-

sociate Justice of this Court, on February 1, 1937, the time for filing a petition for a writ of certiorari was extended to and including February 24, 1937 (R. 86). The petition for writ of certiorari was filed February 23, 1937. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the petitioner is entitled to recover the amounts of income taxes overpaid for the years 1929, 1930, and 1931, where a larger amount of income tax due from the petitioner for the year 1928 on income arising from the same transaction remained unpaid, collection of the 1928 tax being barred by the statute of limitations.

STATUTE INVOLVED

The Revenue Act of 1928, c. 852, 45 Stat. 791, provides in part as follows:

SEC. 44. INSTALLMENT BASIS.

* * * * *

(d) *Gain or loss upon disposition of installment obligations.*—If an installment obligation is satisfied at other than its face value or distributed, transmitted, sold, or otherwise disposed of, gain or loss shall result to the extent of the difference between the basis of the obligation and (1) in the case of satisfaction at other than face value or a sale or exchange—the amount realized, or (2) in case of a distribution, transmis-

sion, or disposition otherwise than by sale or exchange—the fair market value of the obligation at the time of such distribution, transmission, or disposition. The basis of the obligation shall be the excess of the face value of the obligation over an amount equal to the income which would be returnable were the obligation satisfied in full.

STATEMENT

The facts, developed by stipulations (R. 51–58, 60–62), may be summarized as follows:

Petitioner (hereinafter referred to as the estate) is the administrator of the estate of S. C. McEachern, deceased (R. 76–77).

On September 3, 1924, S. C. McEachern, the decedent, sold 500 shares of the capital stock of the Industrial Life & Health Insurance Company for the sum of $300,000. The contract of sale provided that $30,000 was to be paid in cash and the balance in quarterly installments of $7,500 each, payable on March 1, 1925, and on the first day of every third month thereafter. The stock had cost the decedent $10 a share, or a total of $5,000. (R. 77.) In reporting his profit from the sale, the decedent in his lifetime elected to and did report his gain on the installment basis for the years 1924, 1925, 1926, and 1927 (R. 20, 23, 27).

On December 12, 1928, with installments aggregating $150,000 still unpaid, he died intestate (R. 77). On the date of death the unpaid installments had a fair market value of $125,000, arrived

at by discounting their face value ($150,000) at 6.348% per annum from the date of death to the due dates of the installments (R. 52). In the estate tax return there was listed among the assets of the estate "Unpaid balance of deferred payments on 250 shares of stock of Industrial Life & Health Insurance Company under contract between S. C. McEachern and J. N. McEachern, as Trustee, dated September 3, 1924—$125,000.00" (R. 51).

The estate filed income tax returns for 1929, 1930, and 1931, reporting in each year as income the profits on the installments collected in each year, based on the cost of the stock to the decedent, the item in each return being shown as a complete sale of 50 shares made during the year and not as collections on the installment obligations (R. 36, 41, 46, 77–78). By this suit the estate sought the recovery of alleged overpayments (aggregating $3,858.34) of income taxes in those three years, asserting that the income reported was excessive for the reason that only the excess of the respective installments collected over the fair market value of the unpaid installment obligations at the date of decedent's death constituted income to the estate (R. 1–18).

The Government defended on the ground that the estate was not entitled to recover the claimed overpayments of income taxes ($3,858.34) for the years 1929, 1930, and 1931, because a larger amount ($11,625) of income tax for the year 1928, on income arising from the same installment obliga-

tions, was due from the estate and remained unpaid, its collection being barred by the statute of limitations (R. 19–30). The Government contended that under the provisions of Section 44 (d) of the Revenue Act of 1928, *supra,* p. 2, in the income tax return filed by the estate for the income of decedent from January 1, 1928, to date of death, December 12, 1928, a gain should have been reported at the time of the transmission by death of the unpaid installment obligations, but that the said 1928 income tax return did not include such gain; that if such gain had been included, pursuant to Section 44 (d), then "an additional tax in the sum of $11,625.00 would be due and unpaid" (R. 61) by the estate on account of the income tax liability of the decedent for the period from January 1, 1928, to December 12, 1928. The Government further argued that the estate, by reason of its conduct in making out the income tax returns for the income of the decedent in 1928 and the income of the estate in 1929, 1930, and 1931, in an incorrect and misleading manner as above stated, should not now, limitation having barred the collection of the larger tax due for 1928, be entitled or permitted to recover the alleged overpayments made on the incorrect returns for 1929, 1930, and 1931 (R. 19–30, 60–62, 77–78).

When the claims for refund upon which this suit is founded were filed, the time for making an additional assessment for the 1928 period had already expired (R. 5, 10, 15–16, 60).

The estate took the position that it was not, under the facts, precluded from recovery of the overpayments in question, and, further, that Section 44 (d), upon which the larger tax for 1928 is based, is unconstitutional (R. 62–64, 79). The District Court regarded the facts as not constituting an estoppel or otherwise operating to defeat the suit, and not therefore passing on the constitutionality of Section 44 (d), directed a verdict and entered judgment in favor of the estate (R. 31,-32, 64, 67). The Circuit Court of Appeals reversed the judgment of the District Court and held, first, that Section 44 (d) is constitutional; and, second, that the estate was not entitled to recover the overpayments for 1929, 1930, and 1931 on the income from the installment obligations because a larger amount of income tax due for the year 1928 on the same installment obligations remained unpaid, and hence the estate could not claim that the defendant collector "has money which, ex aequo et bono, the defendant ought to refund" (R. 76–80). The court concluded that the estate could not use a suit for refund to obtain money which the estate "ought not in good conscience, to have back" (R. 81).

ARGUMENT

The petition proceeds on the theory that the decision of the Circuit Court of Appeals is on the ground of estoppel. As reasons for granting the writ it is urged (Pet. 5–6) that the decision below is in conflict with the decisions on the question of

estoppel in the cases of *Salvage* v. *Commissioner,* 76 F. (2d) 112 (C. C. A. 2d), affirmed, 297 U. S. 106; *Commissioner* v. *Union Pacific R. Co.,* 86 F. (2d) 637 (C. C. A. 2d); *Hull* v. *Commissioner* (C. C. A. 4th), decided January 5, 1937, not officially reported but found in 1937 Prentice-Hall, Vol. I, p. 1078; that the question of estoppel in Federal income tax cases is important; and that the decision of the court below in the instant case is similar, on the question of estoppel, to the decision in *Commissioner* v. *Farren,* 82 F. (2d) 141 (C. C. A. 10th), in which this Court granted certiorari (298 U. S. 653), but which was dismissed by stipulation of the parties on October 26, 1936. In the brief in support thereof, the conflicts above mentioned with decisions on estoppel, the importance of the question of estoppel in income tax cases, and the similarity to the decision on estoppel in the *Farren* case are discussed (pp. 9–17).

The decision of the Circuit Court of Appeals does not rest on estoppel. It rests on recoupment. It is submitted, therefore, that the reasons advanced for the granting of the writ are without merit.

The court below, in its opinion, expressly stated (R. 80) that its decision was not based upon estoppel. The court said (R. 79–80):

> We come then, to consider appellee's case as it really stands, the case of one who, though on a correct basis should have paid considerably more as taxes on account of

> these installment obligations than he has paid on an incorrect basis, cannot, because of the course he has taken, limitation having now run, be made to pay on the correct basis. So considering it, we think it perfectly plain that though the sums he paid were paid on a particular theory of obligation which did not exist, he may not recover these sums back because they are in sum less than the amount which on a correct theory of obligation, he ought to have paid on account of these installment obligations. This is so not because of the existence of a technical estoppel or a waiver, but because his action was equitable in its nature and grounds, and he may not succeed in it unless he can show that the defendant has money which, ex aequo et bono, the defendant ought to refund.

In *Lewis* v. *Reynolds,* 284 U. S. 281, this Court has definitely recognized the right of the United States to recoupment of an unpaid tax even where the collection of it would be barred by limitation. In *Bull* v. *United States,* 295 U. S. 247, this Court reaffirmed the applicability of recoupment by way of defense to a demand for taxes. It is established by a long line of authorities that recoupment is particularly applicable to actions for the recovery of taxes, because such an action is in the nature of an action for money had and received, which, although in form at law, is governed by equitable principles, and because in such an action a plaintiff cannot recover unless he can show that in

equity and good conscience he is entitled to money which the defendant *ex aequo et bono* should pay back. *Bull* v. *United States, supra; Lewis* v. *Reynolds, supra; United States* v. *Jefferson Electric Co.,* 291 U. S. 386; *United States Paper Exports Ass'n* v. *Bowers,* 80 F. (2d) 82 (C. C. A. 2d); *Hartwell Mills* v. *Rose,* 61 F. (2d) 441 (C. C. A. 5th); *Champ Spring Co.* v. *United States,* 47 F. (2d) 1 (C. C. A. 8th), certiorari denied, 283 U. S. 852; *New York Life Insurance Co.* v. *Anderson,* 257 Fed. 576 (S. D. N. Y.); *Crossett Lumber Co.* v. *United States* (C. C. A. 8th), decided February 8, 1937, not officially reported but found in 1937 Prentice-Hall, Vol. I, p. 1294; *Lit* v. *United States,* (E. D. Pa.), decided February 26, 1937, not officially reported but found in 1937 Prentice-Hall, Vol. I, p. 1326. As this Court said in the *Jefferson Electric* case, at page 402:

> * * * the statutes providing for refunds and for suits on claims therefor proceed on the same equitable principles that underlie an action in assumpsit for money had and received. Of such an action it rightly has been said:
>
> "This is often called an equitable action and is less restricted and fettered by technical rules and formalities than any other form of action. It aims at the abstract justice of the case, and looks solely to the inquiry, whether the defendant holds money, which *ex aequo et bono* belongs to the plaintiff. It was encouraged and, to a great extent, brought into use by that great

> and just judge, Lord Mansfield, and from his day to the present, has been constantly resorted to in all cases coming within its broad principles. It approaches nearer to a bill in equity than any other common law action."

In such an action to recover taxes the defendant can assert by way of defense a counterdemand for recoupment of a claim arising from the same transaction as that which is the basis of the plaintiff's suit. And it is immaterial that the counterdemand would be barred by the statute of limitations. As this Court stated in *Bull* v. *United States, supra* (p. 262):

> * * * recoupment is in the nature of a defense arising out of some feature of the transaction upon which the plaintiff's action is grounded. Such a defense is never barred by the statute of limitations so long as the main action itself is timely.

Hence in the instant case the Government was entitled to recoupment of its claim for the 1928 tax which arose from the same transaction out of which the estate's claim arose; and the court below correctly so decided. *Bull* v. *United States; Lewis* v. *Reynolds; Crossett Lumber Co.* v. *United States; United States Paper Exports Ass'n.* v. *Bowers; Champ Spring Co.* v. *United States; Lit* v. *United States;* all *supra.*

A word may be said about the attack upon the constitutionality of Section 44 (d), which was

made below. Although such charge is reasserted in the specifications of error (No. 4, Pet. 8), nothing is said in support thereof in the brief. The court below held that the section was constitutional (R. 79). Other courts have uniformly held it constitutional (*Provident Trust Co. of Philadelphia* v. *Commissioner,* 76 F. (2d) 810 (C. C. A. 3d); *Crane* v. *Helvering,* 76 F. (2d) 99 (C. C. A. 2d); *Nuckolls* v. *United States,* 76 F. (2d) 357 (C. C. A. 10th)) even where the installment sale was made, as here, before the passage of the 1928 Revenue Act. *Lawler* v. *Commissioner,* 78 F. (2d) 567 (C. C. A. 9th); *Moore* v. *United States,* 10 F. Supp. 143 (C. Cls.), certiorari denied, 296 U. S. 583.

CONCLUSION

The decision of the Circuit Court of Appeals is correct and is in accord with applicable decisions of this Court and of inferior courts. There is no conflict of decisions. The petition should be denied.

Respectfully submitted.

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